No. 82-2159

Office - Supreme Court, U.S.
FILED
JUL 21 1983
ALEXANDER L. STEVAS,
CLERK

In The

# Supreme Court of the United States

October Term, 1982

In re B.D. INTERNATIONAL DISCOUNT CORP.,
*Debtor-Petitioner.*

B.D. INTERNATIONAL DISCOUNT CORP.,
*Petitioner,*

*vs.*

CHASE MANHATTAN BANK, N.A.,
*Respondent.*

**PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT**

ORENSTEIN SNITOW & SUTAK P.C.
750 Third Avenue
New York, New York 10017
(212) 687-1166

SIEGEL, SOMMERS & SCHWARTZ
Two Park Avenue
New York, New York 10016
(212) 689-7570
*Attorneys for Petitioner*

*Of Counsel:*
LEONARD SCHWARTZ
FRANKLYN H. SNITOW
WILLIAM H. PAULEY, III
FRANK J. WEINICK

7502
Ets Appellate Printers, Inc. •NJ (201) 257-6850•NY (212) 840-9494•PA (215) 563-5587 MA (617) 542-1114•DC (202) 783-7288•USA (800) 221-0008

## QUESTIONS PRESENTED

1. Whether a putative debtor has been deprived of its right to a trial under 11 U.S.C. §303(h) where it was forced into bankruptcy for failing to adduce evidence of its defenses while being precluded from presenting such evidence?

2. Whether a single petitioning creditor may involuntarily force a putative debtor into bankruptcy where that debtor refuses in good faith to pay one large disputed debt?

## TABLE OF CONTENTS

*Contents*

*Page*

## TABLE OF CITATIONS

**Cases Cited:**

*Contents*

*Contents*

*Page*

No.

In The

# Supreme Court of the United States

In re B.D. INTERNATIONAL DISCOUNT CORP.,

*Debtor-Petitioner,*

B.D. INTERNATIONAL DISCOUNT CORP.,

*Petitioner,*

-against-

CHASE MANHATTAN BANK, N.A.,

*Respondent.*

## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

### OPINIONS BELOW

The Court of Appeals issued an opinion on March 4, 1983 which is reported at 701 F. 2d 1071 (2d Cir. 1983) (3a), and rendered an order without opinion on April 4, 1983 denying a petition for rehearing of the March 4 opinion (1a). On June 25, 1982, the District Court entered an order without opinion which is not reported. The November 25, 1981 decision and opinion

of the Bankruptcy Court is reported at 15 B.R. 755 (Bankr. S.D.N.Y 1981) (22a) and the April 12, 1981 decision and opinion of the Bankruptcy Court is reported at 13 B.R. 635 (Bankr. S.D.N.Y. 1981) (46a).

## JURISDICTION

The opinion of the Court of Appeals (3a) was made and entered March 4, 1983. A petition for rehearing was denied and entered April 4, 1983 (1a). The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

## STATUTE INVOLVED

The Bankruptcy Reform Act of 1978, as amended, provides in relevant part as follows at 11 U.S.C. §303:

> "(b) An involuntary case is commenced by the filing with the bankruptcy court of a petition under chapter 7 or 11 of this title—
>
> (1) by three or more entities, each of which is either a holder of a claim against such person that is not contingent as to liability or an indenture trustee representing such a holder, if such claims aggregate at least $5,000 more than the value of any lien on property of the debtor securing such claims held by the holders of such claims;
>
> * * *

(h) If the petition is not timely controverted, the court shall order relief against the debtor in an involuntary case under the chapter under which the petition was filed. Otherwise, *after trial,* the court shall order relief against the debtor in an involuntary case under the chapter under which the petition was filed, *only if*—

> (1) *the debtor is generally not paying such debtor's debts as such debts become due;* or
>
> (2) within 120 days before the date of the filing of the petition, a custodian, other than a trustee, receiver, or agent appointed or authorized to take charge of less than substantially all of the property of the debtor for the purpose of enforcing a lien against such property, was appointed or took possession." (Emphasis supplied.)

## STATEMENT OF THE CASE

On May 13, 1981, the respondent Chase Manhattan Bank, N.A. ("Chase") filed a single creditor involuntary petition against petitioner B.D. International Discount Corp. ("B.D. International") under 11 U.S.C. §303. B.D. International moved to dismiss Chase's involuntary petition or, alternatively, to have the United States Bankruptcy Court abstain from exercising jurisdiction.

Each of the parties submitted affidavits and Bankruptcy Judge Burton R. Lifland then heard statements by counsel before handing down an opinion and decision dated August 12, 1981 (46a) denying the motion to dismiss and declining to abstain. Thereafter, B.D. International answered the involuntary petition, discovery was conducted and a trial of the issues raised under 11 U.S.C. §303(h) was held on October 16, and October 19, 1981.

At the trial, Chase presented evidence through two witnesses: William Aimetti, a Group Executive at Chase who was responsible for securities processing, and S. Edward Orenstein, a member of Orenstein Snitow & Sutak, P.C., the attorneys for B.D. International. Aimetti testified that Chase's claim arose from erroneous credits to B.D. International's government securities account in October and November 1979. Relying on documents prepared by Chase officials, Aimetti testified that B.D. International's account had been erroneously credited with a total of $7,268,245.69. Aimetti then explained that these erroneous credits were not charged against B.D. International's account for more than a year because some employees at Chase "were not following the proper procedures."

At the trial mandated by 11 U.S.C. §303(h)(2), B.D. International's attorneys attempted to introduce, through cross-examination, facts which constitute complete defenses to Chase's

claim. Those defenses involved the acts of terminated Chase employees as well as the acts of former B.D. International employees. Chase's counsel immediately and strenuously objected to the introduction of such evidence. Briscoe Smith, Chase's counsel, stated:

> "MR. SMITH: I would cite Your Honor to the *Covey* case in the 7th Circuit, which lays out the law which we briefed to Your Honor, if you had an opportunity to take a look at our trial memorandum, which points out the criteria which have to be met as a matter of law before on the determination of whether the alleged debtor is generally meeting its debts as they fall due, the criteria that have to be met before the Court can get into resolution of the merits of a disputed claim.
>
> On our case and at this point in time we think the law is premature for the Court to resolve the merits of the dispute. We already have in this case evidence, and an admission, if you will, by Mr. Snitow that the resolution of the claim, the disputed claim is going to involve complex questions of negligence."

Chase's counsel reminded the Bankruptcy Court that it had previously stricken B.D. International's ". . . affirmative defenses which had to do with negligence and estoppel and all kinds of things that Mr. Schwartz (B.D. International's counsel) is now . . . asking Mr. Aimetti about." Mr. Smith concluded by stating that it was inappropriate at trial to "get into" the "merits" of the claim. In the end, the Bankruptcy Court ruled that Chase held a *disputed* claim and that B.D. International could not introduce evidence of its defenses at trial. Judge Lifland held:

"I want the record to be clear at the point in time we are not reaching the disputed issue."

Judge Lifland sustained Mr. Smith's objection and precluded inquiry at trial into B.D. International's defenses to Chase's claims, including *inter alia,* the defense of equitable estoppel, stating: "I am not opening up the door for you to try all issues that you raised in the state court proceeding . . . at this time." Citing *Matter of Covey,* 605 F. 2d 877 (7th Cir. 1981), Judge Lifland held that evidence should not be taken concerning B.D. International's defenses to Chase's claim. He concluded that B.D. International's defenses to Chase's claims are only reached after the petitioning creditor has proven that the debtor is generally not paying its debts as such debts become due and an order for relief has been entered. Then, and only then, will the bankruptcy court "sort out and resolve" what Judge Lifland had already determined are "complex questions of law and fact regarding banking transactions and negligence allegations." (32a).

In sustaining the lower court the Second Circuit found that: "[B.D. International] . . . was not paying Citibank; it had not paid Wilkie Farr; [and] it had not paid the City of New York for several years." The payment or non-payment of these alleged creditors was never even mentioned by Chase at trial, notwithstanding Chase's access to B.D. International's books and records and its deposition of B.D. International's President.

The only reference to Citibank in any court proceeding occurred when an individual appeared at a hearing, identified himself as being associated with Citibank and made an unsworn statement that Citibank was investigating its claim. Chase never adduced any evidence concerning any debt allegedly owed by B.D. International to Citibank. Yet, the Second Circuit inexplicably found that B.D. International was not paying Citibank.

This finding presumably suggests a further finding that the Citibank debt was overdue, yet no evidence concerning the alleged debt was introduced at trial or in any prior proceeding. The court's finding with regard to Wilkie Farr and the City of New York suffer the same infirmities (*see* pp. 16 - 17, *infra*). There was no evidence adduced at trial concerning these matters. There is simply no evidence, in the record below, to support the conclusions reached.

Despite Judge Lifland's rulings at trial and his finding of complex questions of law and fact regarding B.D. International's defenses, Judge Lifland found that B.D. International was at fault for not presenting evidence regarding the "nature" of its dispute with Chase (32a). His holding is in direct conflict with his holdings both at trial and in his opinion. Beyond that, it is contradicted by his earlier ruling striking B.D. International's affirmative defenses to Chase's claim which were asserted in B.D. International's answer. The Second Circuit compounded the error below by finding that "after having been afforded the opportunity, B.D. International failed to demonstrate to the bankruptcy court what ground it had for disputing Chase's claim." (12a).

The nature of Chase's claim, including Chase's failure to report the erroneous credits in a commercially reasonable manner to B.D. International, is presently the subject of vigorous litigation in a state court action between Chase and numerous individuals and corporate defendants, not including B.D. International.

Chase then called S. Edward Orenstein to the stand for the purpose of introducing financial statements of B.D. International into evidence. Those financial statements were an integral part of the compromise negotiations in which Orenstein had participated as an attorney for B.D. International and were transmitted by Orenstein in that capacity to Chase. As to the contents of the financial statements, Orenstein testified that he

did not prepare any part of the financial statements; that none of the figures were prepared under his supervision; that he could not vouch for their truth or accuracy; and that he had not even reviewed the financial statements before sending them to Chase.

Although Chase directed the Court's attention to a "current liability" in that financial statement identified as "Payable to bank $7,269,052", Chase offered no testimony to explain the meaning of that entry. In light of the accountant's advice that the information included in the financial statements was the representation of management, the entry "Payable to bank $7,269,052" reflects nothing more than the resolution reached with Chase in the context of compromise negotiations. Indeed, it was Chase that requested financial statements in the course of compromise negotiations. This alleged admission must be viewed in the context of the ongoing compromise negotiations. More importantly, the Court must recognize that this admission, which was relied on by the courts below, was not weighed against the evidence which Chase objected to and the court excluded, *i.e.*, the evidence supporting B.D. International's affirmative defenses. Thus, this alleged "admission" could and would have been explained at trial had the court allowed B.D. International the right to present evidence of its defenses.

Without calling any further witnesses, although two former officers of B.D. International had been subpoenaed by Chase and were present in the courtroom, Chase rested. At the close of Chase's case, the court granted Chase's motion to amend its involuntary petition to incorporate a claim under 11 U.S.C. §303(h)(2) for the appointment of a custodian. Chase never presented any evidence at trial concerning B.D. International's debt structure or liquidation of its debts. It only introduced evidence relating to its single claim.

B.D. International moved to dismiss Chase's claims under §§303(h)(1) and 303(h)(2) and then rested.

On November 25, 1981, Judge Lifland filed an opinion and decision granting an order for relief against B.D. International under §303(h)(1) on the grounds that B.D. International was generally not paying its debts as such debts became due, but denying relief under §303(h)(2) on the grounds that no custodian had been appointed or had taken possession of the appellant's property. B.D. International appealed from so much of the opinion and decision as granted an order for relief on §303(h)(1) grounds.[1]

## REASONS FOR GRANTING THE WRIT

### I.

**The Circuit Courts that have addressed the question of the proof required to put a debtor into involuntary bankruptcy under the new Code have rendered conflicting decisions.**

The Bankruptcy Reform Act of 1978 (the "Code") replaced the prior Bankruptcy Act in October, 1978. The Code represents a substantial departure[2] from the Act in many respects, and consequently the "ever prolific body of case law developing in this area" (37a) has not yet established principles of law to govern determinations of individual cases.

This petition presents an important question that has split the Circuit Courts and has not yet been resolved by this Court: when is a debtor "generally not paying such debtor's debts as they become due," under 11 U.S.C. §303(h)(1)? The importance

---

1. Chase did not appeal from the portion of the opinion and decision that denied an order for relief on §303(h)(2) grounds.

2. *See, e.g., Northern Pipeline Construction Co. v. Marathon Pipeline Co.*, ___ U.S. ___, 102 S. Ct. 2858, 2862 (1982) (plurality opinion).

of this issue is manifest. If the debtor is found to be "generally not paying such debtor's debts as such debts become due," it will be forced involuntarily into bankruptcy. Conversely, if the debtor prevails on this issue, the involuntary petition will be dismissed and all bankruptcy proceedings against the debtor will be terminated.

The only evidence introduced at the trial mandated by section 303(h) was Chase's $7.2 million disputed claim. The court held that this claim comprised approximately 98% of the total *identified* debt of B.D. International (38a).

The court's holding on the basis of "identified" debts does not comport with the requirements of §303(h), especially where the petitioner made no attempt at trial to introduce into evidence either the putative debtor's debt structure or its alleged failure to liquidate those debts known to the petitioner. The *ad damnum* clause of a concededly disputed claim does not constitute the predicate for calculating the debt structure of a putative debtor. Chase was responsible, after having been provided with discovery, for proving the *actual* debts of B.D. International at trial and that entity's alleged failure to liquidate those debts as they became due. The Second Circuit had no basis for finding that the Chase claim "constituted some 98% of the *total debt*. . . ." (10a). (Emphasis supplied). Similarly, the Second Circuit erred in finding that any other debt was overdue since Chase never adduced any evidence on that issue at trial (11a-12a).

The other Circuit Court that has addressed the issue of what evidence should be considered by the bankruptcy courts at trial has not reached the same conclusion. The Seventh Circuit held that the resolution of the merits of the disputed claim should be deferred until after the §303(h) trial,[3] while the Second Circuit

---

3. *Matter of Covey*, 650 F. 2d 877, 883 (7th Cir. 1981). There, the Seventh Circuit established a balancing test to be applied at the §303(h) trial to determine the propriety of involuntary bankruptcy.

required B.D. International "to demonstrate to the bankruptcy court what ground it had for disputing Chase's claim." (12a). Indeed the Second Circuit specifically questioned the "elaborate gloss" that the Seventh Circuit added to "the treacherously simple statutory language." (13a).

Beyond the conceded conflict between the Circuits lies a more fundamental problem. On the basis of the Seventh Circuit's decision in *Covey*, the Bankruptcy Court below precluded B.D. International from proving its defenses to Chase's claim. However, the Second Circuit affirmed the Bankruptcy Court's entry of an order for relief on the grounds that "after having been afforded the opportunity, B.D.I. failed to demonstrate to the bankruptcy court what ground it had for disputing Chase's claim." (12a). The Second Circuit apparently overlooked the "catch-22" that it and the Bankruptcy Court created for B.D. International.[4] In

---

4. The Second Circuit stated in its opinion:

> "Still we have difficulty in believing that Congress intended that a debtor should be found to be generally not paying its debts as they become due under 303(h)(1) or that a claim qualifies under 303(b), when the claim is subject to serious dispute. As said in *In re Nar-Jor Enterprises Corp.*, 6 B.R. 584, 586 (Bankr. S.D. Fla. 1980), the bankruptcy courts were 'not designed or intended to be the forum for trying isolated disputed claims.' But here, after having been afforded the opportunity, B.D.I. failed to demonstrate to the bankruptcy court what ground it had for disputing Chase's claim. In order to qualify a claim as a basis for seeking involuntary bankruptcy, a claimant need not make out a case warranting summary judgment although in fact Chase came close to this (11). It is sufficient to establish, as Chase did here, that there are good grounds for the claim and that no defenses have been asserted in substantiable form. Whether less may suffice we need not decide." (12a-13a).

(Cont'd)

so doing, the Second Circuit effectively deprived B.D. International of its right to a trial under §303(h) while holding that it should be placed in bankruptcy because it did not introduce its defenses at trial. Such an anomaly is supported by neither law nor logic.

Since B.D. International was precluded from adducing its defenses at trial, it cannot be said that B.D. International was "afforded the opportunity" to dispute Chase's claim. Thus, since a serious dispute existed between Chase and B.D. International, as conceded by Chase's counsel and held by the Bankruptcy Court below, Chase's petition, unsupported by any other evidence at trial, should have been dismissed. As Judge Friendly opined on behalf of the Second Circuit,

> ". . .we have difficulty in believing that Congress intended that a debtor should be found to be generally not paying its debts as they become due under 303(h)(1) or that a claim qualifies under 303(b), when the claim is subject to serious dispute." (12a).

Accordingly, B.D. International respectfully requests this Court to grant the instant petition for certiorari to resolve the conflict between the Circuits and to remedy this miscarriage of justice.

---

(Cont'd)

What the court inexplicably ignored is that the Bankruptcy Court, upon motion of Chase, dismissed B.D. International's affirmative defenses on the grounds that they were not to be heard at the 303(h) trial and then went onto exclude *all* evidence designed to bring the nature of those defenses to the Court's attention at that trial. Clearly B.D. International cannot be faulted for not introducing that which was expressly excluded at trial.

## II.

**A single petitioning creditor may not involuntarily force a putative debtor into bankruptcy where that debtor refuses in good faith to pay one large disputed debt.**

As this Court has recently reaffirmed, the Bankruptcy Courts are courts of limited jurisdiction. In order for a petitioning creditor to involuntarily force a debtor into bankruptcy, the creditor must prove, at a trial, that "the debtor is generally not paying such debtor's debts as such debts become due." 11 U.S.C. §303(h)(1).[5]

Although the Code does not define the phrase "generally not paying such debtor's debts as such debts become due," both the legislative history and the court opinions construing this language unequivocally indicate that a range of factors must be considered in making such a determination.

Initial Congressional drafts of this section of the Code used the language "generally unable to pay" (the House version) and "generally unable to pay or has failed to pay a major portion thereof" (the Senate version). *See, In re Arker,* 6 B.C.D. 1281, 1283 (Bankr. E.D.N.Y. 1980). Ultimately, the language enacted by Congress specifically omitted any test based upon an inability of the debtor to pay. Indeed, the Bankruptcy Court noted in its November 25, 1981 Opinion that the most significant departure from the prior law was the grounds for involuntary bankruptcy, which have substituted an "equity insolvency test" for "balance sheet insolvency and an act of bankruptcy." (36a). *See also* House Report No. 95-595, 95th Cong., 1st Sess. (1977) 323; Senate Report

---

5. Although not relevant in this proceeding, a creditor may also obtain an order for relief if a custodian for the debtor's funds has been appointed. *See* 11 U.S.C. §303(h)(2).

95-989, 95th Cong., 2d Sess. (1978) 34. In so doing, Congress "intended that the court consider both number and amount in determining whether the inability or failure [to pay] is general." *Report of the Commission on the Bankruptcy Laws of the United States*, Part 11, at p. 75 (1973). The legislative history also makes it "clear that the court must find more than prospective inability to pay only a few of the debtor's liabilities *when they fall due* and more than a past failure to pay only a few of his debts." *Ibid.*

In construing the legislative history and the language of §303(h)(1), courts have held that the Code requires proof of a regular course of conduct in which the debtor is not paying its debts as they mature. *In re All Media Properties, Inc.*, 5 B.R. 126 (Bankr. S.D. Texas 1980), *aff'd*, 646 F. 2d 193 (5th Cir. 1981); *Matter of Luftek, Inc.*, 6 B.R. 539 (Bankr. E.D.N.Y. 1980); *Matter of 7H Land & Cattle Co.*, 6 B.R. 29 (Bankr. D. Nevada 1980); *Matter of Trans-High Corp.*, 3 B.R. 1 (Bankr. S.D.N.Y. 1980). In considering whether a petitioning creditor has met its burden of proof under §303(h)(1), courts have looked to "both the number and amount [of the debtor's obligations] in determining whether the inability or failure to pay is general." *In re Chong*, 6 B.C.D. 865, 867 (Bankr. D. Hawaii 1980).

The Bankruptcy Court in *In re Reed*, 11 B.R. 755, 759-760 (Bankr. S.D. W.Va. 1981) identified four factors to be examined in determining whether the petitioning creditor had proven a case at trial under §303(h)(1). There, the court described those criteria as:

> "the number of debts, the amount of delinquency, the materiality of non-payment and the nature of the debtor's conduct of his financial affairs." 11 B.R. at 760.

Of course, each Bankruptcy Judge has emphasized some of these emerging criteria in order to adequately address the fact

situation before him. However, the focus of these inquiries is the same — "whether non-payment of debt is the alleged debtor's regular course of conduct." *Luftek*, 6 B.R. at 543.

In sum, mere failure to pay a debt is not enough. *In re Nar-Jor Enterprises Corp.*, 6 B.R. 584, 586 (Bankr. S.D. Fla. 1980). A bona fide dispute might not only explain but fully justify a debtor's failure to pay. *Covey*, 650 F. 2d at 883; *All Media*, 5 B.R. at 135-136; *Reed*, 11 B.R. at 760. The Second Circuit in the case at bar expressed disbelief that a disputed claim could form the basis for a finding that a debtor is generally not paying its debts as they become due under §303(h)(1) (12a).

This proposition rests on the salutary principle that the Bankruptcy Courts were not designed by Congress to function as collection agencies.[6] *In re SBA Factors v. Miami, Inc.*, 13 B.R. 99, 100-101 (Bankr. S.D. Fla. 1981). Such a use of the Bankruptcy Courts would quickly paralyze bankruptcy administration. *Id.* If the law were otherwise, the holder of a claim would be able to force a debtor into bankruptcy merely by inflating the size of its claim. The Bankruptcy Courts would then have no choice but to enter an order of relief even though the debt was admittedly disputed. Such a result would be contrary to logic and the law.

In this case, Chase expressly acknowledged that its debt is disputed and therefore the entry of an order of relief against B.D. International may only be supported by its failure to generally not pay other debts as those debts became due. But Chase never

---

6. Chase itself tacitly concedes this point by virtue of the state court action it filed prior to filing the instant involuntary petition to collect the same $7.2 million allegedly owed by B.D. International. It is clear that Chase commenced this action merely to pressure the state court defendants into capitulating. Such use of the Bankruptcy Courts must be curbed.

introduced any evidence at all as to the terms of repayment of the other putative claimants of B.D. International.

The illogic of the Second Circuit's analysis is that the fewer debts that a petitioning creditor proves at trial, the more likely it is that a single claim may result in the entry of an order for relief under section 303(h)(1). In effect, the Second Circuit has eliminated the petitioning creditor's burden of proving that the debtor's handling of its financial affairs justifies involuntarily forcing the debtor into bankruptcy.[7] Yet even under this truncated burden of proof, the Second Circuit found that the resolution of this issue "is a close one." (4a-5a).

Aside from the question of overdueness, the Second Circuit erred in concluding that Citibank, Willkie Farr and the City of New York were B.D. International's creditors (11a-12a). The only support for Citibank's claim was the unsworn statement of an individual who appeared on behalf of Citibank at the August 6, 1981 hearing. At that time, Citibank's representative stated that it was still investigating its claim. B.D. International represented that Citibank's claim was a bookkeeping entry for a money difference.[8] Citibank never appeared at trial and never filed a proof of claim.

As for Wilkie Farr, that claim was extinguished by a compromise and paid by a third party. Contrary to the Second Circuit's finding that "the record afforded no basis for determining whether the payor of Willkie Farr is subrogated to its claim" (18a,

---

7. This finding is curious in light of the Second Circuit's specific recognition of Chase's burden of proving that "the 'debtor is generally not paying such debtor's debts as such debts become due.' " (4a).

8. A money difference arises when there is a failure of the parties in a securities transaction to record the proper interest rate.

n.10), the record is clear that the payor waived any right he had to become a creditor of B.D. International. Like Citibank, neither Willkie Farr nor the payor filed a proof of claim.

Finally, the alleged debt to the City of New York is vitiated by B.D. International's refund claim which was filed with the City of New York. Indeed, it should be noted that the refund claim exceeded the proof of claim

In sum, Chase did not demonstrate that any claim against B.D. International was overdue and unpaid. Accordingly, there is nothing in the record to support the Second Circuit's affirmance of the Bankruptcy Court's finding that B.D. International "is generally not paying such debtor's debts *as such debts become due*" under 11 U.S.C. §303(h)(1) (emphasis added). This Court is respectfully requested to grant the instant petition for certiorari to remedy this miscarriage of justice.

## CONCLUSION

For the foregoing reasons, this Court is respectfully requested to grant the petition for certiorari.

Dated: New York, New York
June 28, 1983

Respectfully submitted,

FRANKLYN H. SNITOW
ORENSTEIN SNITOW &
SUTAK, P.C.
750 Third Avenue
New York, New York 10017
(212) 687-1166

SIEGEL, SOMMERS &
SCHWARTZ
2 Park Avenue
New York, New York 10016
(212) 689-7570

*Attorneys for Petitioner*

*Of Counsel:*

LEONARD SCHWARTZ
WILLIAM H. PAULEY, III
FRANK J. WENICK

## APPENDIX

## ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT DENYING PETITION FOR REHEARING FILED APRIL 4, 1983

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse, in the City of New York, on the fourth day of April, one thousand nine hundred and eighty-three.

No. 82-5031

IN RE:

B.D. INTERNATIONAL DISCOUNT CORP.,

Debtor-Appellant.

---

B.D. INTERNATIONAL DISCOUNT CORP.,

Plaintiff-Appellant,

v.

CHASE MANHATTAN BANK, N.A.,

Defendant-Appellee.

A petition for a rehearing having been filed herein by counsel for the plaintiff-appellant, B.D. International Discount Corp.,

*Order*

Upon consideration thereof, it is

Ordered that said petition be and it hereby is DENIED.

A. Daniel Fusaro, Clerk
by Francis X. Gindhart
Chief Deputy Clerk

**OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT FILED MARCH 4, 1983**

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 616 August Term 1982

(Argued December 17, 1982 Decided March 4, 1983)

Docket No. 82-5031

IN RE:

B.D. INTERNATIONAL DISCOUNT CORP.,

Debtor-Appellant.

---

B.D. INTERNATIONAL DISCOUNT CORP.,

Plaintiff-Appellant,

v.

CHASE MANHATTAN BANK, N.A.,

Defendant-Appellee.

Before FRIENDLY and NEWMAN, Circuit Judges, and WYZANSKI, District Judge.*

---

* United States District Judge for the District of Massachusetts, sitting by designation.

*Opinion*

Appeal by a debtor in a proceeding under Chapter 7 of the Bankruptcy Code from an order of the District Court for the Southern District of New York, David N. Edelstein, *Judge,* which affirmed the entry of an order for relief under Chapter 7 by Bankruptcy Judge Lifland, 15 B.R. 755 (Bankr. S.D.N.Y. 1981).

Affirmed.

Franklyn Snitow, New York, NY (Orenstein, Snitow, Sutak & Pollack, P.C., New York, NY and Siegel, Sommers & Schwartz, New York, NY), for Plaintiff-Appellant.

Briscoe Smith, New York, NY (Milbank, Tweed, Hadley & McCloy, New York, NY, Suzanne M. McSorley, Of Counsel), for Defendant-Appellee.

Friendly, *Circuit Judge:*

This appeal is from an order of Judge Edelstein in the District Court for the Southern District of New York which affirmed an order entered by Bankruptcy Judge Lifland, 15 B.R. 755 (Bankr. S.D.N.Y. 1981), granting a creditor's petition for involuntary bankruptcy under §303(b)(2) and (h) of the Bankruptcy Code. The debtor contended that the order was improperly granted on two grounds: The first was the failure of the petitioning creditor to show that the "debtor is generally not paying such debtor's debts as such debts become due". The second was that the indebtedness to the petitioning creditor was disputed. Although such questions are often difficult to resolve, and the first is a

close one here, we have concluded that the bankruptcy judge and the district court correctly granted relief in this case.

B.D. International Discount Corporation (B.D.I.) was in the business of trading bankers acceptances and other money market instruments. For more than ten years B.D.I. maintained its principal bank accounts at the Chase Manhattan Bank (Chase). On three separate occasions Chase mistakenly credited B.D.I.'s checking account with sums in the massive total amount of $7,268,745.92. These incorrect credits took place on October 3, 1979, October 4, 1979, and November 16, 1979, but were not discovered by Chase until late November, 1980. In November, 1980, B.D.I. transferred a total of $4.3 million from its account at Chase to a bank in Holland for the account of its sole stockholder, Segrex, S.A., a Swiss corporation. By the end of that month, B.D.I. had ceased operating, and had transferred its remaining assets of $240,000 into its attorney's escrow account. On November 28, 1980, a new entity, B.D. Discount of America, Inc. was created. This corporation engages in the same type of business and operates at the same location as B.D.I. had done.

On December 3, 1980, Chase demanded repayment from B.D.I. A series of negotiations took place between representatives of Chase and representatives of B.D.I. During the course of the subsequent bankruptcy proceedings, it was learned that in April, 1981, B.D.I. received a $710,000 payment from a third party in settlement of litigation, and that this money was not held in B.D.I.'s attorney's escrow account but was transferred to the account of Segrex as a loan. On May 13, 1981, after negotiations between Chase and B.D.I. had proved fruitless, Chase filed an involuntary petition in bankruptcy under §303(b)(2) seeking the entry of an order for relief under Chapter 7 (liquidation) of the Bankruptcy Code, 11 U.S.C. §303(b)(2).[1]

*Opinion*

B.D.I. moved that the bankruptcy court should dismiss the petition primarily on the ground that Chase did not qualify as a petitioner under §303(b)(2) since its claim was contingent[2] or, alternatively, that the court should abstain under §305.[3] B.D.I. also raised the question whether Chase had shown that B.D.I. was generally not paying its debts as they became due — an issue more properly reserved for the trial under §303(h)[4] — and the bankruptcy judge dealt with this in his opinion denying the motion to dismiss, 13 B.R. 635, 638-39 (Bankr. S.D.N.Y. 1981), as well as in his opinion after the trial, 15 B.R. at 759-63 (Bankr. S.D.N.Y. 1981). In the list of creditors B.D.I. filed pursuant to court order and Bankruptcy Rule 104(e), it named four identified creditors, whose claims were stated to be "contingent, disputed, and unliquidated" and "[t]hree or fewer Unidentified Beneficial Owners of certain GNMA pool securities (identities and addresses unknown)". The former group included Chase and Citibank, N.A. The latter appeared at the hearing and represented that it was owed "at least $2300.00" by B.D.I. *In re B.D. International Discount Corp., supra,* 13 B.R. at 639. B.D.I. conceded in open court that at the time of its motion to dismiss the petition, the law firm of Willkie, Farr & Gallagher had been a creditor in the amount of $75,000, *id.*, but stated that the law firm's claim had been paid by Howard O'Flynn, a former officer of B.D.I. In addition, the City of New York filed a Proof of Claim of $43,320.00 for unpaid occupancy and corporation taxes, some of which had been unpaid since June, 1977. Finding that Chase's claim was not contingent and that there was no sound basis for abstention, the Bankruptcy Judge denied B.D.I.'s motion for dismissal or abstention but permitted it to file an answer to the petition within five days "limited to the statutory grounds set forth in §303(h)(1)(2)." 13 B.R. at 640.

Under the mistaken impression that the denial of its motion to dismiss would preclude it from contesting at the trial the validity

of the Chase claim for the purposes of 11 U.S.C. §303(h)(1), B.D.I. took an interlocutory appeal to the District Court for the Southern District of New York. That court, Sofaer, J., held that B.D.I. was not precluded from later contesting the validity of the Chase claim at the §303(h)(1) trial, and went on to say that "the Bankruptcy Judge should be doing something to permit himself at least to know that there is at least a substantial basis for the debt, something like that, even if it is not a definitive determination that the debt is owing."

Thereafter a trial was held pursuant to §303(h). Chase presented persuasive testimony concerning the validity of its claim. Specifically, William Aimetti, the executive responsible for securities services at the bank carefully documented, through testimony and internal memoranda kept in the ordinary course of business, the nature of Chase's claim against B.D.I. Bankruptcy Judge Lifland found this testimony to be both "competent and credible." 15 B.R. at 762. In addition to this documentation, Aimetti testified to a telephone conversation between himself and Rudolfo Cusamano, then president of B.D.I., in which Cusamano acknowledged the accuracy of bank records which summarized and documented the three transactions that gave rise to the Chase claims but sought to arrive at a mutually satisfactory schedule of repayments, 15 B.R. at 761. Also of significance were financial statements of B.D.I., prepared by B.D.I.'s accountants, which contained the following entry: "Payable to Bank $7,269,052." The Bankruptcy Court properly considered this to be a "damaging admission", 15 B.R. at 762.[3]

In contrast, while formally denying the validity of its debt to Chase, B.D.I. "did not offer a scintilla of substantive proof to rebut the Chase claim", 15 B.R. at 762.[4] On the basis of the evidence presented by Chase and the absence of any contrary evidence, Bankruptcy Judge Lifland concluded that "Chase clearly

established a 'substantial basis' for its claim", 15 B.R. at 762, and therefore included the claim in his determination whether B.D.I. was generally not paying its debts under 11 U.S.C. §303(h)(1). Final adjudication of the validity of the Chase claim was postponed and is to be resolved in a subsequent trial. 15 B.R. at 764 n.26.

The Bankruptcy Court then went on to conclude that B.D.I. was generally not paying its debts as they became due, basing its conclusion on what it described as the "totality of the record before the Court." 15 B.R. at 764.[7] The principal factors that led to this conclusion were: *first,* that B.D.I. had ceased its business operations entirely and had placed all of its assets in a lawyer's escrow account; *second,* that the past due debt to Chase comprised an exceedingly large share of the debtor's assets; and, *third,* that the Bankruptcy Court considered there were "special circumstances" that made the administration of this case in the bankruptcy court "appropriate." Among these special circumstances were the transfer of $4.3 million out of the country to Segrex, the subsequent $710,000 loan to Segrex, and the creation of B.D.I.'s successor entity, B.D. Discount of America. 15 B.R. at 764. Accordingly it granted relief under §303(h).

The debtor appealed to the district court which affirmed substantially on the opinion of the Bankruptcy Judge. It then appealed to this court.

The provisions of §303(h) were an innovative provision of the Bankruptcy Code, replacing the acts of bankruptcy required for involuntary bankruptcy by §3a(1)-(6) of the Act of 1898. Unhappily the language "the debtor is generally not paying such debtor's debts as such debts become due" is woefully lacking in clarity.

The legislative history sheds a limited amount of light. Putting aside the portion of the history relating to what is now §303(h)(2), the story runs as follows: The bill recommended by the Commission on the Bankruptcy Laws of the United States, 93d Cong., 1st Sess., House Document No. 93-137, Part II, p. 74, provided in §4-205(c):

> Relief may be directed on a creditor's petition
>
> (1) if the debtor will be generally unable to pay his current liabilities as they become due;
>
> (2) if the debtor has generally failed to pay his debts as they become due . . .

An accompanying note explained, *id.* at 75:

> 5. *Subdivision* (c) generally substitutes the equity test of insolvency for an act of bankruptcy as the ground for involuntary relief. The existence or nonexistence of this ground should be more easily determined than an act of bankruptcy, as defined in §3a(1)-(6) of the present Act, and insolvency as defined in §1(19) of the present Act, as of the time of the act or the petition if the first act is relied on. The scope and meaning of "generally unable" and "generally failed" are left to the courts; it is not possible to lay down guidelines that will fit all cases. However, it is clear that the court must find more than prospective inability to pay only a few of the debtor's liabilities when they fall due and more than a past failure to pay only a few of his debts. It is intended that the court consider both number and amount in determining whether the inability or failure is general.

*Opinion*

Neither the House nor the Senate bill as reported by the respective Judiciary Committee adopted the language recommended by the Commission. Under §303(h) of the House bill, 95th Cong., 1st Sess., H.R. 8200, the sole test was whether "the debtor is generally unable to pay such debtor's debts as such debts become due." The accompanying report, 95th Cong., 1st Sess., H.R. Rep. No. 95-595, p. 323, after summarizing the statute, said simply:

> The equity insolvency test has been in equity jurisprudence for hundreds of years, and though it is new in the bankruptcy context (except in chapter X), the bankruptcy courts should have no difficulty in applying it.[1]

The Senate bill, 95th Cong. 1st Sess., S. 2266, was considerably more favorable to the grant of relief where a single large creditor or only a few such creditors sought bankruptcy. Its version of §303(h)(1), authorized such relief, p. 322, if "the debtor is generally unable to pay *or has failed to pay a major portion of his debts as such debts become due.*" (Emphasis supplied.) Under the italicized language, a creditor like Chase whose claim constituted some 98% of the total debt would clearly prevail since it would meet the second branch of the test whether it met the first or not. The accompanying report, 95th Cong., 2d Sess., S. Rep. No. 95-989, p. 34, was silent on this difference between the bill reported by the Senate Judiciary Committee and that which had been reported by its counterpart in the House. It contented itself with the same reassuring words contained in the House report. There was no conference committee report, but Representative Edwards, who had been a member of the Bankruptcy Commission and sponsor of the House bill, said, on the floor of the House, 124 Cong. Rec. H 11091 (Sept. 28, 1978):

*Opinion*

> Section 303(h)(1) in the House amendment is a compromise of standards found in H.R. 8200 as passed by the House and the Senate amendment pertaining to the standards that must be met in order to obtain an order for relief in an involuntary case under title 11. The language specifies that the court will order such relief only if the debtor is generally not paying debtor's debts as they become due.

The "compromise" was the substitution of "is generally not paying" for "is generally unable to pay"; the Senate's alternative test, failure to pay a major portion of the debts, disappeared.

The history thus clearly points to insistence by Congress on generality of default. Plainly also, as said in 2 Collier, Bankruptcy (15th ed. 1982), ¶303.12 at 303-50:

> The application of this test by the courts is proving to be somewhat difficult despite the comforting words of the legislative history to section 303(h)(1).

The many cases cited in this section of the Collier treatise emphasize that if Congress thought it had provided a test that would lead to quick and sure determinations, it was badly misadvised and should consider returning to the drawing board.

We do not think this is the case in which we should attempt to lay down a definitive rule. Here, the bankruptcy judge was justified in finding that B.D.I. was generally not paying its debts as they became due on any reasonable interpretation of that language. It was not paying Chase; it was not paying Citibank; it had not paid Willkie Farr;' it had not paid the City of New York for several years. We do not agree with B.D.I. that the evidence was defective because Citibank's attorney was not sure

of the precise amount of its claim or because Willkie Farr[10] and the City were not called to give testimony. B.D.I. conceded the indebtedness to Willkie Farr, and the City's proof of claim was sufficient in the absence of any contention that the amount was not owed. Under the peculiar circumstances of this case, this evidence seems sufficient to meet the test of generality.

B.D.I. contends that even if these conclusions are correct, which it of course denies, a disputed claim, such as that of Chase, cannot be considered a debt the debtor is not paying since Congress could not have intended to allow a creditor to force a debtor into bankruptcy because the debtor exercised its right to have a court pass on the validity of a claim. Chase responds that the statutory text requires disputed claims to be treated on a parity with undisputed ones. The argument runs as follows: Section 101(11) defines "debt" as "liability on a claim" and §101(4) defines "claim" as "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, *disputed,* undisputed, legal, equitable, secured, or unsecured" (emphasis supplied). Chase finds further support for its position in the fact that the only claims specifically ruled out by §303(b)(1) are contingent claims; the bankruptcy judge correctly held that Chase's claim did not fall into that category. Still we have difficulty in believing that Congress intended that a debtor should be found to be generally not paying its debts as they become due under §303(h)(1) or that a claim qualifies under §303(b), when the claim is subject to serious dispute. As said in *In re Nar-Jor Enterprises Corp.*, 6 B.R. 584, 586 (Bankr. S.D. Fla. 1980), the bankruptcy courts were "not designed or intended to be the forum for trying isolated disputed claims." But here, after having been afforded the opportunity, B.D.I. failed to demonstrate to the bankruptcy court what ground it had for disputing Chase's claim. In order to qualify a claim as a basis for seeking involuntary bankruptcy, a claimant need not make out a case warranting

summary judgment although in fact Chase came close to this.[11] It is sufficient to establish, as Chase did here, that there are good grounds for the claim and that no defenses have been asserted in substantiable form. Whether less may suffice we need not decide.

Both parties have discussed at length what appears to be the only appellate decision on the treatment of disputed claims for the purpose here in question, *Matter of Covey,* 650 F.2d 877 (7 Cir. 1981). In *Covey* the late Judge Sprecher developed an intricate balancing formula, designed to afford a rule of decision in all cases, with respect to the inclusion of disputed debts in the "generally not paying debts" determination. Apart from the question whether the treacherously simple statutory language will support so elaborate a gloss, we think it a bit early in the day to essay a "guideline" opinion on this subject. As Justice Harlan said, dissenting in *Sanders v. United States,* 373 U.S. 1, 32 (1963), such opinions "suffer the danger of pitfalls that usually go with judging in a vacuum. However carefully written, they are apt in their application to carry unintended consequences which once accomplished are not always easy to repair." We prefer to see some more cases before we decide whether to accept *Covey,* either as written or in a modified form, as the law of this circuit, although our decision here is consistent with it.

We realize that, by deciding both phases of this case upon the particular facts here presented, we are not giving bankruptcy judges the guidance which they doubtless desire and it is our duty to provide if we properly can. But it is better to fail in this respect than to attempt to give guidance without having seen the variety of factual situations, having heard the adversary presentations, and having the benefit of scholarly commentary which time will undoubtedly afford.[12] Drawing the lines under §303(h), both as to generality and also as to the status of disputed claims, will

be assisted "by the gradual approach and contact of decisions on the opposing sides." *Noble State Bank v. Haskill*, 219 U.S. 104, 112 (1911) (Holmes, J.); *see also Davidson v. New Orleans*, 96 U.S. 97, 104 (1877). It suffices to decide this case that the bankruptcy judge was warranted in finding that B.D.I. was failing to pay not merely Chase but all other creditors and thus was generally not paying its debts as they became due, and that Chase was not disqualified as a petitioning creditor under §303(b) or as the holder of debt that was not being paid by B.D.I. by virtue of a purported dispute which B.D.I. did not sufficiently support.

Affirmed.

*Opinion*

1. Section 303(b) provides:

> An involuntary case is commenced by the filing with the bankruptcy court of a petition under chapter 7 or 11 of this title—
>
> (1) by three or more entities, each of which is either a holder of a claim against such person that is not contingent as to liability or an indenture trustee representing such a holder, if such claims aggregate at least $5,000 more than the value of any lien on property of the debtor securing such claims held by the holders of such claims;
>
> (2) if there are fewer than 12 such holders, excluding any employee or insider of such person and any transferee of a transfer that is voidable under section 544, 545, 547, 548, 549, or 724(a) of this title, by one or more of such holders that hold in the aggregate at least $5,000 of such claims.

2. A contingent claim is "one which the debtor will be called upon to pay only upon the occurrence or happening of an extrinsic event which will trigger the liability of the debtor to the alleged creditor and if such triggering event or occurrence was one reasonably contemplated by the debtor and creditor at the time the event giving rise to the claim occurred." *In Re All Media Properties*, 5 B.R. 126, 133 (Bankr. S.D. Texas 1980)

3. This provides

> Abstention
>
> (a) The court, after notice and a hearing, may dismiss a case under this title, or may suspend all

proceedings in a case under this title, at any time if—

(1) the interest of creditors and the debtor would be better served by such dismissal; or

(2)(A) there is pending a foreign proceeding; and

(B) the factors specified in section 304(c) of this title warrant such dismissal or suspension.

(b) A foreign representative may seek dismissal or suspension under subsection (a)(2) of this section.

(c) An order under subsection (a) of this section dismissing a case or suspending all proceedings in a case, or a decision not so to dismiss or suspend, is not reviewable by appeal or otherwise.

4. Section 303(h) provides:

If the petition is not timely controverted, the court shall order relief against the debtor in an involuntary case under the chapter under which the petition was filed. Otherwise, after trial, the court shall order relief against the debtor in an involuntary case under the chapter under which the petition was filed, only if—

(1) the debtor is generally not paying such debtor's debts as such debts become due; or

> (2) within 120 days before the date of the filing of the petition, a custodian, other than a trustee, receiver, or agent appointed or authorized to take charge of less than substantially all of the property of the debtor for the purpose of enforcing a lien against such property, was appointed or took possession.

11 U.S.C. §303(h).

5. We see no merit in B.D.I.'s claim that the court could not properly take account of this since it was "[e]vidence of conduct or statements made in compromise negotiations." F.R.E. 408. The rule "does not require the exclusion of any evidence otherwise discoverable merely because it is presented in the course of compromise negotiations". Furthermore Rule 408 is limited to cases of "compromising or attempting to compromise a claim which was disputed as to either validity or amount." At the time of negotiation B.D.I. did not dispute Chase's claim; it was simply endeavoring to get more time in which to pay. *See* 2 Weinstein's Evidence ¶408[1] at 408-410 (1981).

6. Counsel for B.D.I. stated that determination of the dispute in regard to Chase's claim "will needlessly duplicate proceedings that are already underway in the State Court, and that, I might add, have been vigorously litigated on both sides" and that among the issues being litigated in the state court were "complicated issues of negligence that will necessarily require a jury trial." (J.A. 54a-55a). Counsel did not offer any part of the state court record in evidence. Counsel has cited no authority for the proposition that a bank's negligence in overcrediting a customer is a defense to the bank's claim for an amount which the customer must have known to have been credited in error.

7. We see no reason why, as B.D.I. contends, evidence taken at the dismissal hearing could not be considered as supplementing that taken at the trial.

8. This ignored that the equity insolvency test said nothing about "generally", see Collier, Bankruptcy, 14th ed. ¶1.19, p. 99 n.10—the word that creates all the trouble. Even in the situation where there would seem to be the least objection to an involuntary "single creditor" bankruptcy, namely, when the debtor is a corporation and there is no prospect of rehabilitation under Chapter 11, Congress might have thought that such a proceeding would serve neither of the two major purposes of bankruptcy—achieving equality among creditors and giving the debtor a fresh start, *Burlingham v. Crouse*, 228 U.S. 459, 473 (1913); *Roslyn Savings Bank v. Comcoach*, No. 82-5027, slip ops. 1235, 1239 (2 Cir., January 13, 1983). Although appointment of a trustee would make available to the single creditor more remedies not available under state law, Congress could have considered that the resources of the bankruptcy system should not be devoted to such cases.

9. We assume that the critical date is that of the petition rather than of the trial, although the statute is ambiguous on this point.

10. The record affords no basis for determining whether the payor of Willkie Farr is subrogated to its claim.

11. It is settled that a lititgant faced with a sufficiently supported motion for summary judgment cannot simply sit back and say "I have a good answer to all this but I won't disclose it now." See, e.g., *First National Bank of Arizona v. Cities Service Co.*, 391 U.S. 253, 289 (1967) (party cannot rest on mere denial

in complaint in opposition to properly supported summary judgment motion); *Markowtiz v. Republic Nat'l Bank of N.Y.*, 651 F.2d 825, 827 (2 Cir. 1981) (opposing party may not rest on mere conclusory allegations); *SEC v. Research Automation Corp.*, 585 F.2d 31, 33 (2 Cir. 1978) (party opposing summary judgment must set forth concrete objections); *Dressler v. The M.V. Sandpiper*, 331 F.2d 130, 133 (2 Cir. 1964) (same). *See also* F. R. Civ. P. 56(e) (adverse party may not rest on mere denial of his pleading when summary judgment motion is made).

12. We add, although without too much hope in light of the many pressing problems with which it is faced, the possibility that, having beheld the disarray in the bankruptcy courts, Congress will clarify just what is desired with respect to generality in making this important change in the test for involuntary bankruptcy.

## ORDER OF UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK DATED JUNE 25, 1982

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

82 Civ. 0206 (DNE)

In re

B. D. INTERNATIONAL DISCOUNT CORP.,

Debtor-Appellant.

EDELSTEIN, District Judge:

After careful consideration of the arguments presented to this Court by counsel in the memoranda they have submitted and at oral argument, and after reviewing the record of the proceedings before the Bankruptcy Court, the Court finds that:

1. WHEREAS the Bankruptcy Court correctly found under 11 U.S.C. §303(h)(1) that appellant B. D. International Discount Corp. is generally not paying its debts as such debts become due so as to justify the entry of an order for relief; and

2. WHEREAS the Bankruptcy Court's finding that appellant is generally not paying its debts as such debts become due is supported by competent evidence contained in the record of the proceedings before the Bankruptcy Court; and

3. WHEREAS a consideration of the record of the proceedings before the Bankruptcy Court satisfies this Court that the findings of fact and conclusions of law set forth by Bankruptcy Judge Lifland are not clearly erroneous.

*Order*

IT IS HEREBY ORDERED that the entry by the Bankruptcy Court of an order for relief under Chapter 7 of the Bankruptcy Code, 11 U.S.C. §§101 *et seq.*, is affirmed.

Dated: New York, New York
June 25, 1982

s/ David N. Edelstein
U.S.D.C.

## OPINION AND DECISION OF UNITED STATES BANKRUPTCY COURT, SOUTHERN DISTRICT OF NEW YORK FILED NOVEMBER 25, 1981

UNITED STATES BANKRUPTY COURT
SOUTHERN DISTRICT OF NEW YORK

No. 81 11019

In the Matter

of

B.D. INTERNATIONAL DISCOUNT CORP.,

Debtor.

APPEARANCES:

Orenstein, Snitow, Sutak & Pollack, P.C.,
Attorneys for Debtor,
750 Third Avenue
New York, New York

By: S. Edward Orenstein, Esq.,
and
William Pauley, III, Esq., of Counsel

Siegel, Sommers & Schwartz, Esqs.,
Attorneys for Debtor,
Two Park Avenue
New York, New York

By: Leonard Schwartz, Esq., of Counsel

*Opinion and Decision*

Milbank, Tweed, Hadley & McCloy, Esqs.,
Attorneys for Chase Manhattan Bank,
One Chase Manhattan Plaza
New York, New York

By: Briscoe R. Smith, Esq.,
Alan W. Kornberg, Esq.,
and Suzanne McSorley, Esq., of Counsel

Burton R. Lifland, *United States Bankruptcy Judge*

Chase Manhattan Bank (National Association) ("Chase") filed an involuntary petition in bankruptcy, 11 U.S.C. §303(b), seeking the entry of an order for relief under Chapter 7 (liquidation) of the Bankruptcy Reform Act of 1978 (the "Code")[1] against B.D. International Discount Corporation ("B.D. International"), a now dormant dealer in bankers acceptances and other money market instruments, on May 13, 1981. The gravamen of the petition alleges that the proposed debtor is liable to Chase for some seven million plus dollars mistakenly credited to the account of B.D. International in three separate banking transactions. In an attempt to elide the proceeding, B.D. International moved for dismissal of the involuntary petition on the ground that Chase is an ineligible petitioner because its claim

1. The Bankruptcy Act of 1898 (the "Act") has been superseded by the Bankruptcy Reform Act of 1978, Pub.L. 95-598, 92 Stat. 2549, as of October 1, 1979. The law relating to bankruptcy is codified in title 11 of the United States Code.

is "contingent as to liability", 11 U.S.C. §303(b)(1)[2], or, in the alternative, for the Court to abstain pursuant to 11 U.S.C. §305.[3]

Following two hearings, this Court declined to grant either branch of B.D. International's motion, *In Re B.D. International Discount Corp.*, 13 B.R. 635 (Bankr. Ct. S.D.N.Y. August 12,

---

2. Chapter 3 applies in cases under Chapter 7 by the force of 11 U.S.C. §103(a). In pertinent part, §303(b)(1) states:

> (b) an involuntary case is commenced by the filing with the bankruptcy court of a petition under Chapter 7 or 11 of this title—
>
> (1) by three or more entities, each of which is either a *holder of a claim against such person that is not contingent as to liability*. . . (emphasis added)
>
> • • •

See, 11 U.S.C. §§101(4) ("Claim"), (14) ("Entity"), (30) ("Person"), (31) ("Petition"); 101(2) ("claim against the debtor").

3. §305 Abstention

> (a) The court after notice and a hearing, may dismiss a case under this title, or may suspend all proceedings in a case under this title, at any time if—
>
> (1) the interests of creditors and the debtor would be better served by such dismissal or suspension; or
>
> • • •

See, 11 U.S.C. §§102(1) ("After notice and a hearing"); 101(9) ("creditor"), (14) ("debtor").

1981), finding instead that (1) while disputed, the Chase claim is not contingent as to liability; (2) that Chase is not the sole creditor in this case; (3) that even if Chase were the sole creditor, special circumstances had been displayed which made bankruptcy administration appropriate;[4] and (4) that abstention was not in the best interest of creditors because of the spectre of fraudulent activities. The debtor was permitted to file an answer[5] limited

---

4. Key among these circumstances was a November 6, 1980 transfer of $4.3 million out of the country to B.D. International's sole shareholder/parent, Segrex, S.A., a Swiss corporation, and a subsequent $710,000 loan to Segrex in April of 1981, this latter transaction apparently consisting of funds similar to those that had gone into an escrow fund established by B.D. International when it ceased doing business.[a] In the interim, a new entity, B.D. Discount of America was created and engages in the same type of business as B.D. International. Chase alleges that these combined actions are part of a fraudulent scheme by those in control of B.D. International who with knowledge that they held Chase's money went about stripping B.D. International of its assets while they continue in business without the burden of obligations to creditors through B.D. Discount of America. 13 B.R. at 638.

(a) See note 24 *infra*; Slater aff'd para. 8, Snitow aff'd para. 11 (Exhibit 2).

5. "An involuntary case is in essence a civil suit requesting a judgment that an order for relief be entered based on the provisions of §303(h)(1) and (2)."

*In re Alpine Lumber and Nursery*, 13 B.R. 977, 979 (Bankr. Ct. S.D.CA 1981)

The sought after "order and relief", 11 U.S.C. §102(6), (a phrase that supplants the term "adjudication" under the former Act, §1(2), (former) 11 U.S.C. §1(2)) must be granted unless the "debtor", 11 U.S.C. §101(12), (formerly referred to as the "bankrupt" in liquidation under the Act, §1(4), (former) 11 U.S.C. §1(4)) timely controverts the petition. See *Matter of Nina Merchandise Corp.*, 5 B.R. 743, 2 C.B.C. 2d 1098, 6 B.C.D. 910, Bankr. Law R. (CCH) P67, 689 (Bankr. Ct. S.D.N.Y. 1980).

to the grounds set forth in 11 U.S.C. §303(h)(1)&(2).[6] An appeal followed.

On review in the district court[7] before the presiding Part I Judge, the Honorable Abraham D. Sofaer dismissed B.D. International's appeal[8] of this Court's interlocutory order. The appeal apparently stemmed from misplaced concern that further challenge to the bona fides of the Chase claim had been foreclosed by this Court's preliminary determinations under 11 U.S.C. §303(b). The District Court appropriately interpreted this Court's opinion as not precluding B.D. International from later contesting the validity of the Chase claim under 11 U.S.C. §303(h)(1), as opposed to the threshold limitation on filings by those holding claims "contingent as to liability" of 11 U.S.C. §303(b)(1), a

---

6. (h) . . . (A)fter trial, the court shall order relief against the debtor in an involuntary case under the chapter under which the petition was filed, only if —

> (1) the debtor is generally not paying such debtor's debts as such debts become due; or
>
> (2) within 120 days before the date of the filing of the petition, a custodian, other than a trustee, receiver, or agent appointed or authorized to take charge of less than substantially all of the property of the debtor for the purpose of enforcing a lien against such property, was appointed or took possession.

See, 11 U.S.C. §§101(12) ("Debtor"), (31) ("Petition"), (11) ("debt"), (10) ("Custodian"), (28) ("lien"); 102(6) ("order for relief").

7. See 28 U.S.C. §1334. Bankruptcy Appeals (District Courts).

8. Treated as an application for leave to appeal under Interim Rule of Bankruptcy Procedure 8004(d) (adopted as S.D.N.Y. local bankruptcy rules). See District Court transcript, September 8, 1981, at 14.

"thorny" issue earlier dealt with extensively in *Matter of Covey*, 650 F.2d 877, 882-884, 4 C.B.C. 2d 719, 7 B.C.D. 1969, Bankr. Law R. (CCH) para. 67, 851 (7th Cir. 1981).

Thereafter, B.D. International filed a padded answer and jury demand, which upon the motion of Chase was truncated by this Court's striking of those counts that exceeded the scope of the permitted response (outlined at 13 B. R. 640). An evidentiary hearing based upon the statutory grounds set forth in 11 U.S.C. §303(h)(1)&(2)[9] followed on October 16 and 19, 1981, without a jury.[10] Chase's presentation consisted of testimony by William Aimetti, the Group Executive responsible for the Securities Services Group at Chase; books and records produced by B.D. International;[11] memoranda prepared by Chase officials; and various affidavits and documentation from the record in this case. The debtor apparently relying upon its assumption that the petitioning creditor failed to meet its burden of proof rested at the conclusion of Chase's case without presenting any further evidence or witness testimony.

B.D. International's position in contravention of an order for relief can be summarized thusly: (1) Chase did not prove its debt; the evidence submitted was insufficient; (2) If there was

---

9. At trial Chase was permitted to amend its involuntary petition to include 11 U.S.C. §303(h)(2) (property in hands of a custodian); See Fed. R. Civ. P. 15, Bankruptcy Rule 715. See note 6, *supra*.

10. See 28 U.S.C. §1480(b), (Jury Trials); *In re Liza Chong*, 2 C.B.C. 2d 1037, 6 B.C.D. 865 (Bankr. Ct. Hawaii 1980).

11. See Interim Bankruptcy Rule 1008 (discovery in support of an involuntary petition); *In re Petrotex Minerals, Inc.*, 5 B.R. 29, 1 C.B.C. 2d 1065, 6 B.C.D. 357 (Bankr. Ct. N.C. Ga. 1980.

a debt, Chase did not show the terms of payment or the time it expected the debt to be paid; (3) A single overdue debt cannot satisfy the standard of generally not paying debts as they become due. As will be demonstrated, none of these arguments is persuasive.

At the outset, the Court must focus on the question of what did Chase, the petitioning creditor, have to show in order to succeed, and did it make this necessary showing? Stated differently, just how far did Chase have to go to carry the day?

This is a proceeding pursuant to 11 U.S.C. §303(h) to determine the appropriateness of commencing an involuntary bankruptcy case, not, as B.D. International would prefer, an objection to a claim made during the ordinary course of bankruptcy administration. It follows that the proffered proof in this instance must be measured with an eye to the charge of the Code for speedy resolution of the involuntary bankruptcy question. See Interim Bankruptcy Rule 1009 which commands a determination at the earliest practicable time".

The District Court implicitly recognized the tension between the need for prompt resolution to protect creditors and potential harm to an involuntarily petitioned debtor vindicated by a favorable determination of a disputed debt in subsequent litigation when it articulated:

> . . .(T)he Bankruptcy Judge should be doing something to permit himself at least to know that there is at least a substantial basis for the debt, something like that, even if it is not a definitive determination that the debt is owing.

September 8, 1981 transcript at 21, District Court, Part I, Hon. Abraham D. Sofaer. While no doubt an improvidently filed involuntary petition (ie: by one without a valid claim) can wreak havoc on an innocent debtor, this potential harm must be juxtaposed with the need to ensure that earnest creditors promptly receive all of the rights and protections afforded by the bankruptcy laws, lest the assets of the estate be squandered and secreted away by a financially troubled or dishonest debtor. See Report of the Commission on the Bankruptcy Laws of the United States (1973) Part I at 186. Whatever solace it may provide, Congress did provide in 11 U.S.C. §303(i)[12] remedy for an aggrieved debtor

---

12. 11 U.S.C. §303(i). If the court dismisses a petition under this section other than on consent of all petitioners and the debtor, and if the debtor does not waive the right to judgment under this subsection, the court may grant judgment—

(1) against the petitioners and in favor of the debtor for—

(A) costs;

(B) a reasonable attorney's fee; or

(C) any damages proximately caused by the taking of possession of the debtor's property by a trustee appointed under subsection (g) of this section or section 1104 of this title; or

(2) against any petitioner that filed the petition in bad faith, for—

(A) any damages proximately caused by such filing; or

(B) punitive damages.

See Note 16 *infra*.

ultimately successful in setting aside the scarlet letter of involuntary bankruptcy proceedings. Clearly, this puts the errant involuntary petitioning creditor at substantial risk.

The most recent exposition in the area, and the only court of appeals ruling, comes from the Seventh Circuit.

In *Matter of Covey,* 650 F.2d 877 (7th Cir. 1981), the Circuit Court was faced with the argument that "disputed" debts should not be examined in determining whether the debtors were generally paying their debts as those debts became due.[13] It resolved that policy considerations do not support a universal rule of inclusion or exclusion and constructed the following test.

> Thus, disputed debts should be excluded from the "generally paying debts" determination only under the following circumstances: 1) the dispute is whether any claim exists, not merely regarding the amount of a claim; 2) the dispute can be examined without substantial litigation of legal or factual issues; and 3) the interests of the debtor in defeating an order of involuntary bankruptcy outweigh creditors' interests in achieving a somewhat more rapid determination of the involuntary bankruptcy question.

---

13. That those with disputed debts are eligible petitioners under 11 U.S.C. §303(b) has been put to rest and is not at issue in the instant proceeding. See *Covey,* 650 F.2d at 881; *In re All Media Properties, Inc.,* 5 B.R. 126, 2 C.B.C. 2d 449, 6 B.C.D. 586 (Bankr. Ct. Md. 1980); *In re Duty Free Shops Corp.,* 6 B.R. 38 (Bankr. Ct. S.D. Fla. 1980); *In re McNeil,* No. Civ. 2-81-33 (E.D. Tenn. May 5, 1981); *In re B.D. International Discount Corp.,* 13 B.R. 635, 638 (Bankr. Ct. S.D.N.Y. 1981, Lifland, B.J.).

*Id.* at 883-884. Should the proposed debtor prevail under this test, ". . . then the bankruptcy courts should reach the 'dispute' issue." *Id.* In other words, proceed to probe the merits of the claim. During this collateral litigation, "(i)f the *debtor* does establish that the entire debt is barred or otherwise invalid, then the disputed debt should be excluded from the 'generally paying debts' calculation." *Id.* (emphasis added).

The Circuit Court, having set down guidelines for the bankruptcy court, proceeded to review their application in the *Covey* case. Noting first that the nature of the debtors' disputes with respect to certain claims "are not so clear", the court concluded that those disputes require complex factual investigations negating the need to balance interests. Notwithstanding this determination the court continued:

> But even if the creditors' interests were balanced against the debtor's interests, the result of that balancing process does not support the (debtors) position. First, a *strong factor* weighing against the (debtors) is that they *had voluntarily closed their dealership.* There was no ongoing business to be harmed by the stigma of an involuntary bankruptcy.
>
> *Second, the (debtors) disputes seem to represent strategic gamesmanship.* The (debtors) are not disputing some of their business debts. . . . Rather, the (debtors) are disputing 99½% of their business debts. Thus we conclude that the (debtors) interests do not outweigh the interests of the creditors in an expeditious determination of the

bankruptcy question *in order to avoid waste of assets.*

*Id.* at 884. (Emphasis Added).

Following the lead of *Covey* this Court likewise concludes that the "nature" of the instant dispute raised by the debtor (without testimonial explication) is not so clear and that complex questions of law and fact regarding banking transactions and negligence allegations must be sorted out and resolved.[14] Moreover, in gratuitously examining a balancing test, it is readily apparent that creditors' interests far outweigh any danger of harm to the proposed debtor. First, the fact that B.D. International has voluntarily ceased to do business is a "strong factor weighing against (it)." B.D. International's remaining acknowledged tangible assets of $240,000 are held under unknown conditions in an attorney's escrow account.[15] Nor can several serious allegations made earlier by Chase of irregularities in the conduct of business by B.D. International be ignored, including the alleged operation of B.D. International business by a new entity whose alleged purpose is to function without the bother of the obligations of its predecessor and alleged transfers of substantial sums of money amounting to five million dollars to a foreign parent corporation either outright or in the guise of a loan. Such allegations must weigh heavily in favor of bankruptcy administration if creditors interests are to be safeguarded, the debtor being protected from imprudent petitioning creditors by

---

14. See July 23, 1981 Transcript (Bankr. Ct.) at 5, lines 8-9 (Exhibit 3); September 3, 1981 Affidavit in Opposition of Franklyn H. Snitow.

15. See note 24, *infra.*

the fear of sanctions under 11 U.S.C. §303(i).[16] Finally, and borrowing further from *Covey*, "the (debtor's) disputes seem to represent strategic gamesmanship." In addition to its disputes with Chase, the largest claimant, B.D. International has scheduled other claimants as unidentified, or if identified, as contingent.[17] A sole acknowledged creditor was paid off post petition by third party funds[18] (a not uncommon ploy).[19]

In short, the Court concludes that the magnitude of potential harm to creditors far outweighs the interests of this debtor in seeking further delay. There is no need to fully decide the merits of the "dispute" at this juncture and *Covey* so instructs. Nor did the District Court in the appeal of this Court's prior decision require "a definitive determination that the debt is owing" but was only of the opinion that this Court should satisfy itself that there is a "substantial basis for the debt (or) something like that." While satisfaction of the hurdles in *Covey* seems adequate protection, the Court finds ample support in the record to further conclude the claim has a legitimate foundation and that it is not merely colorable.

At trial, Chase called to the stand William Aimetti ("Aimetti"), the Group Executive responsible for the Securities

---

16. *See In re All Media Properties, Inc.*, 5 B.R. 126, 2 C.B.C. 2d 449, 6 B.C.D. 586 (Bankr. Ct. S.D. Tex. 1980); Report of the Commission on the Bankruptcy Laws of the United States (1973) Pt. 1 at 190; See note 12 *supra*.

17. "List of Creditors with Addresses" dated July 29, 1981.

18. "Notice to Admit" and "Response", par.7 (Exhibits 6 and 7).

19. See *Matter of Nina Merchandise Corp.*, 5 B.R. 743, 745, 2 C.B.C. 2d 1098, 6 B.C.D. 910, Bankr. Law R. (CCH) p 67, 689 (Bankr. Ct. S.D.N.Y. 1980).

Services Group at the bank. Within the Group, Aimetti oversees the Federal Funds Department where B.D. International's government securities transactions were cleared. He explained that the errors which form the basis of the Chase claim occurred in 1979, but that due to improper auditing practices by Chase employees, were not discovered and related to him until November, 1980, a year later. The claimed errors consist of three separate banking transactions resulting in over-credits to B.D. International's checking account of approximately $7,200,000 in what appears to be a highly complex system of reconciliation and interaction, often processed via computer, and running through several channels of banking, including the Federal Reserve System.

The Aimetti testimony, bolstered by Chase internal memoranda kept in the ordinary course of its business, (Exhibits 13, 14, 15, 17 and 18) discloses that within the week of discovery, Chase apprised B.D. International of the errors through Rudolfo Cusamano, B.D. International's then president. Thereafter, a series of approximately half a dozen calls and meetings took place over the next two months. At the first meeting, Cusamano was provided with a detailed explanation of the Chase claim, supported by memoranda which summarized and documented with transaction records the erroneous credits (Exhibits 9, 10 and 11). The accuracy of these records was later acknowledged in a telephone conversation between Cusamano and Aimetti. The tone evinced by B.D. International during subsequent exchanges was not denial and disclaim; on the contrary, discussions centered on arriving at a mutually satisfactory schedule of repayment.

In a mid-December meeting, representatives of B.D. International informed Chase that B.D. International had suffered

severe losses[20] in the preceding year and a half and was now dormant, but that certain foreign investors (unidentified) would honor Chase's claim. Chase, however, found the proposal unacceptable without some form of security such as the guarantee of a viable entity or an assignment to it of an earlier mentioned $11 million B.D. International liability reserve account. Neither protection was forthcoming, and in fact, the reserve account had evaporated by this time. Counter-proposals and counter-counter-proposals failed to find favor and apparently negotiations were terminated. Aimetti concluded his direct examination by stating that B.D. International had made no payment on the $7.2 million obligation and that Chase had no lien or security interest in the assets of B.D. International.

In addition to the above testimony, Chase introduced into evidence certain financial statements of B.D. International transmitted by counsel for B.D. International to Chase during

---

20. This is an appropriate juncture in which to reflect upon recent commentary by the Court of Appeals for this circuit in a case dealing with the fraudulent conveyance provisions of §67(d) of the Act (former) 11 U.S.C. §107(d), now embodied in 11 U.S.C. §548 of the Code.

> When an overburdened debtor perceives that he will soon become insolvent, he will often engage in a flurry of transactions in which he transfers his remaining property, either outright or as security, in exchange for consideration that is significantly less valuable than what he has transferred. Although such uneconomical transactions are sometimes merely acts of fecklessness, the calculating debtor may employ them as a means of preferring certain creditors or of placing his assets in friendly hands where he can reach them but his creditors cannot.

*Rubin v. Manufacturers Hanover Trust Co.*, slip op. (2d Cir. Sept. 21, 1981).

the course of the above meetings and prepared by certified public accountants employed by B.D. International. The statement records the following liability: "Payable to Bank $7,269,052." (Exhibits 19, 19A and 6).

The Court finds the Aimetti testimony competent and credible; the financial statement a damaging admission. In short, sufficient evidence has been adduced by Chase to meet its burden of going forward. By raising the "dispute" issue, a collateral matter, it became incumbant upon B.D. International at this juncture to "establish that the entire debt is barred or otherwise invalid," if the claim is to be excluded from the 11 U.S.C. §303(h)(1) calculation. *See Covey, supra* at 883. B.D. International did not offer a scintilla of substantive proof to rebut the Chase claim, rather it attempted to subvert Chase's presentation with attacks pitched to the niceties of pleadings and proof. Chase clearly established a "substantial basis" for its claim and as such, it will be included in the calculation of "generally not paying such debtor's debts as such debts become due."

But what does this phrase "generally not paying such debtor's debts as such debts become due" mean? A definitive answer to this question is not to be found in the Code.

In reforming the standards of involuntary bankruptcy, Congress intended to make it easier to commence proceedings against debtors. Abolished are the "acts of bankruptcy" enumerated in §3a of the Act, (former) 11 U.S.C. §21a, and the balance sheet test of insolvency defined in §1(19) (former) 11 U.S.C. §1(19). In ". . . the most significant departure from (prior) law concerning the grounds for involuntary bankruptcy . . ." an "equity insolvency test" has been substituted. House Report No. 95-595, 95th Cong., 1st Sess. (1977) 323, 324 ("House Report"); *See* Senate Report No. 95-989, 95th Cong., 2d Sess. (1978) 34

("Senate Report"); *Cf.* 124 Cong. Rec. H 11,019 (Sept. 28, 1978); S 17,407 (Oct. 6, 1978) (reflecting changes in later compromise); *Accord Matter of Stebbins, Inc.*, 78 B 1087; 78 Civ. 4302 (MJ) Slip Op. at N.13 (S.D.N.Y. Sept. 17, 1979); *Matter of Hill*, 5 B.R. 79, 82, 2 C.B.C. 2d 646, 6 B.C.D. 659 (Bankr. Ct. Minn. 1980), *Aff'r* 8 B.R. 799, 780, 3 C.B.C. 2d 920 (D.C. Minn. 1981); *In re All Media Properties, Inc.*, 5 B.R. 126, 142 (N. 5), 2 C.B.C. 2d 449, 6 B.C.D. 586 (Bankr. Ct. S.D. Tex. 1980); *In re Duty Free Shops Corp.*, 6 B.R. 38, 40, Bankr. Law R. (CCH) par. 67, 625; *Matter of Luftek, Inc.*, 6 B.R. 539, 546 (Bankr. Ct. E.D.N.Y. 1980); *Matter of Gill Enterprises*, 4 C.B.C. 2d 1312, 1316 (Bankr. Ct. N.J. 1981); *See also* Report of the Commission on the Bankruptcy Laws of the United States, 1973, Pt. 11 at 75 ("Commission Report");[21] 2 *Collier on Bankruptcy* (15th ed.) par. 303.11(1) at 303-27. A test that Congress assumed "the bankruptcy courts should have no difficulty in applying. . . ." House Report at 323. At least it was hoped that "(the) existence or nonexistence of this ground should be more easily determined than acts of bankruptcy. . . ." Commission Report, *supra.*

In reviewing the ever prolific body of case law developing in this area, it becomes clear that the task is not so easy and it is understandable why "it is not possible to lay down guidelines that will fit all cases." Commission Report *supra.* The seemingly endless diversity exhibited by those suffering financial distress, in earnest or feigned, calls for a broad concept that allows "bankruptcy courts enough leeway to be able to deal with the variety of situations that will arise." *All Media, supra* at 143. Not surprisingly, proposed "mechanical tests" have been rejected

---

21. The Commission draft proposed a test which looked to "prospective inability" or "past failure" to meet obligations. This approach was abandoned in favor of an approach that looks to the debtor's present practice.

by the courts. *In re Reed,* 11 B.R. 755, 759, 4 C.B.C. 2d 934, Bankr. Law R. (CCH) par. 68, 047 (Bankr. Ct. S.D. W.Va. 1981); *All Media, supra* (51% or majority test rejected); *Gill Enterprises, supra.*

In *Matter of Hill, supra,* the bankruptcy court approached the statute with a "straightforward and uncomplicated reading." Reasoning that "generally" imports something that involves or is applicable to the "whole" and with regard to the overall picture, as opposed to specific instances, it held that the "generally not paying test" is satisfied where there is non-payment of any single claim which represents an "overwhelming portion" of the total debt, even if the claim is disputed. In this instance, one creditor was owed $1,250,000 out of approximately $1.4 million in claims. Similarly, in *In re Kriedler Import Corp.,* 2 C.B.C. 2d 159, 164, 6 B.C.D. 608 (Bankr. Ct. Md. 1980), it was held that where a debtor failed to make payments on a debt which constitutes a large percentage (here 97%) of its total debt, that debtor has failed generally to pay its debts as they became due, notwithstanding timely payment of a number of smaller debts. *Cf. Matter of Denham,* 444 F.2d 1376 (5th Cir.) (under the Act).

The Chase $7.2 million claim comprises greater than 98% of the total debts identified in the instant proceeding, an overwhelming proportion of the total debt. Thus, under *Hill* and *Kriedler,* sufficient grounds have been shown to justify the entry of an order for relief.

The steadfast position by B.D. International that this case concerns a single creditor or overdue debt is without foundation.[22]

---

22. The Chase claim flows from three separate banking transactions. While Chase has made a demand for repayment in the aggregate, this does not

(Cont'd)

Response to paragraph 7 of Chase's Notice to Admit, admits that Willkie Farr & Gallagher, Esqs. had a claim ($75,000) at the time of the filing of the petition.[23] That this creditor was silenced with third party funds does not eviscerate the debt or shield it from consideration by the Court. *All Media, supra* at 144 and 145. In addition, creditors scheduled by the debtor (no matter what the debtor's strategy may have been in constructing its list pursuant to this Court's order) and proofs of claim submitted independently by creditors, see Bankruptcy Rule 301(b) (proof of claim constitutes prima facie evidence of validity and amount of claim), further dispel and make disingenuous this assertion.

Finally, the Court must reiterate, even if Chase were the sole creditor, "special circumstances" exist which justify the entry of an order for relief. 13 B.R. at 638-639 (citing *In the Matter of 7H Land & Cattle Co.*, 6 B.R. 29, 2 C.B.C. 2d 554, 6 B.C.D. 572, Bankr. Law R. (CCH) par. 67, 951 (Bankr. Ct. Nev. 1980) and *In re Arker*, 6 B.R. 32, 3 C.B.C. 21, 6 B.C.D. 1281 (Bankr. Ct. E.D.N.Y. 1980); *see also In re R.V. Seating, Inc.*, 8 B.R. 663, 665, Bankr. Law R. (CCH) p. 67, 829 (Bankr. Ct. S.D. Fla. 1981); *Reed, supra* at 760 (approving "special circumstances" exception); *In re 7H Land & Cattle Co.*, 8 B.R. 22 (Bankr. Ct. Nev. 1980)).

---

(Cont'd)
necessarily fuse its combined demand into a "single overdue debt." The record is not sufficient in this context to comment further. The Court, however, does make mention that were it faced with a series of sales over a period of time from a single vendor, it would hesitate to lump together several non-payments specifically identifiable to separate transactions under the rubric of "single overdue debt."

23. See note 18 *supra*.

B.D. International's further polemics that 11 U.S.C. §303(h)(1)'s formulation mandates "debts", as opposed to a single debt, or "patterns" of abuse is without authority or support and is at odds with all published decisions on this issue. Its position is misplaced in literal or narrow readings of the statute and inapposite legislative history and case law, or out of context statements therefrom.

Lastly, relying upon *In re Trans-High Corp.*, 3 B.R. 1, 1 C.B.C. 2d 509, 6 B.C.D. 213 (Bankr. Ct. S.D.N.Y. 1980, Ryan, B.J.), B.D. International argues: "Chase has offered no evidence establishing the terms of payment or the time that it expected its alleged debt to be paid. This failure is fatal to Chase's involuntary petition under 11 U.S.C. Sec. 303(h)(1)." Post-trial memorandum at 3-4.

But Chase's claim does not result from a sale of goods or performance of a service. There was no quid pro quo. This is a claim that stems from banking errors. Reasonable commercial practice would dictate that after notification of the over-credits, and following a reasonable period of time sufficient to verify financial records, the entire sum was immediately due. Since at least December 1980, repeated demands have been made by Chase. The record verifies that no payment has been made. Whatever a reasonable period might be, it is not five months (the period between notification and the filing of the involuntary petition). Nor does the fact that B.D. International colors its obligation with "dispute" lead to any other conclusion. The debtor has been given every opportunity to present proof that would bar the Chase claim. In contradiction to its position, B.D. International's very own books of account (Exhibits 19, 19A and 6) smart with the admission of the bank liability. See *All Media, supra* at 145.

Finalizing its fate, the record reveals that B.D. International's cash assets have been sitting in a lawyer's escrow account since May 1981. (Exhibits 1,2,4,5)[24] The nature of a debtor's conduct of his financial affairs has been viewed as a factor in the generally not paying debts determination. Winding up a business and conducting financial affairs in a manner inconsistent with one operating in good faith and in the regular course of business is conduct that may form the foundation for the entry of an order for relief. *Reed, supra* at 760. While this factor *alone* might be insufficient, given the totality of the record before the Court — the enormity of the past due debt(s), the duration of non-payment, the reduction of some assets into an escrow and concomitant non-operating status, and the "special circumstances" brought earlier to the Court's attention — ample support is found for the entry of an order for relief.[25] The petitioning creditor, Chase, has met its burden of proof under 11 U.S.C. §303(h)(1).[26]

## THE 11 U.S.C. §303(h)(2) CUSTODIAN OF ASSETS ALTERNATIVE[27]

The Chase effort to invoke the provisions of §303(h)(2) merits discussion notwithstanding the totally sufficient nourishment of

---

24. See also July 23, 1981 Transcript (Bankr. Ct.) at 6 (Exhibit 3); Part I District Court Transcript at 19-20, September 8, 1981, Hon. Abraham D. Sofaer presiding; October 19, 1981 Transcript (Bankr. Ct.) at 32.

25. *See* sound commentary in the last three paragraphs of Honsberger, "Failure to Pay One's Debts Generally As They Become Due: The Experience of France and Canada," 54 Amer. Bankr. L.J. 153 (Spring 1980) at 162-163.

26. Resolution of the "dispute", put at issue by B.D. International's formal denial of the Chase claim, is properly the subject of resolution in a subsequent trial on the merits.

27. See statute at note 6, *supra*.

the petition under §303(h)(1). Essentially Chase argues that the establishment of a custodial escrow account with the attorney for the debtor, in which all of the debtor's cash on hand assets are held, in of itself mandates the order for relief. Indisputably, substantially all of B.D. International's present tangible assets were turned over to attorneys within 120 days of the filing of the petition. (Exhibits 1,2,4 and 5) The question presented then is whether the attorneys are the custodian contemplated by the statute.

"Custodian" is defined by 11 U.S.C. §101(10) as:

> (A) receiver or trustee of any property of the debtor, appointed in a case or proceeding not under this title;
>
> (B) assignee under a general assignment for the benefit of the debtor's creditors; or
>
> (c) trustee, receiver, or *agent* under applicable law, or *under a contract,* that is appointed or authorized to take charge of property of the debtor for the purpose of enforcing a lien against such property, or *for the purpose of general administration of such property for the benefit of the debtor's creditors;*

(emphasis added).

The definition's legislative history explains that "custodian" is a new term introduced into the Code, "to facilitate drafting and means prepetition liquidator of the debtor's property, such as an assignee for the benefit of creditors, a receiver of the debtor's property, or a liquidator or administrator of the debtor's property." House Report at 310; Senate Report at 21.

Additional legislative comment under §303(h)(2) sheds further light on the concept.

> The second test, appointment of a custodian within 90 days before the petition, is provided for simplicity. It is not a partial reenactment of the acts of bankruptcy. If a custodian of all or substantially all of the property of the debtor has been appointed, this paragraph creates an irrebutable (sic) presumption that the debtor is unable to pay its debts as they mature. Moreover, once a proceeding to liquidate assets has been commenced, the debtor's creditors have an absolute right to have the liquidation (or reorganization) proceed in the bankruptcy court and under the bankruptcy laws with all of the appropriate creditor and debtor protections that those laws provide.

House Report at 323-324; *see* Senate Report at 34; *see also* 124 Cong. Rec. H 11091 (September 28, 1978); S 17,407 (October 6, 1978) (reflecting later changes).

It appears, therefore, that if a debtor's assets are to be subjected to a bankruptcy-like liquidation or reorganization without the protection of the bankruptcy court or laws, creditors are entitled to circumvent such process and receive the protections afforded by the Bankruptcy Code if they act timely. *Cf. In re North County Chrysler-Plymouth, Inc.*, 7 B.C.D. 1409 (Bankr. Ct. W.D. Mo. 1981) (auctioneer not a custodian because he had no responsibility for paying the debtor's debts.) The onus was upon Chase, however, to demonstrate that the law firm is a prepetition liquidator of B.D. International's assets for the benefit of B.D.'s creditors with responsibility akin to a trustee, receiver or other similar agent or fiduciary to distribute those assets.

Chase failed to establish that the law firm had the responsibility of liquidating all or any part of the debtor's property. There is nothing in the record concerning the conditions or terms of the escrow agreement. There was nothing to indicate that B.D. International could not revest itself with the fund.

The right of a "custodian" to retain or hold property must be in derogation of the debtor's proprietary rights to the property in order to satisfy the custodial requirements of the statute.

Under these circumstances Chase has not established that a "custodian" was appointed or took possession pursuant to 11 U.S.C. §303(h)(2).

The predicate for relief under §303(h)(1) having been established, the Court, in conformity with Interim Rule of Bankruptcy Procedure 1009(c), is entering a separate order of relief[28] and the Clerk of the Bankruptcy Court is directed to docket same.

Dated: New York, New York
November 25, 1981

s/ Burton R. Lifland
UNITED STATES
BANKRUPTCY JUDGE

---

28. By its answer to the involuntary petition and response to Chase's Notice to Admit, B.D. International has established the following factors which satisfy this Court's jurisdictional predicates: 1) that it is a domestic corporation; 2) that its principal place of business was located in this district for the 180 days immediately preceding the filing of the petition; 3) that it is a person against whom an order for relief may be entered against under Title 11 of the United States Code; and, 4) that all the creditors of the debtor are less than twelve in number.

See 11 U.S.C. §§109(a) and (b); 303(a) and (b)(2); 28 U.S.C. §1472.

*Opinion and Decision*

ORDER FOR RELIEF

UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

Case No. 81 B 11019

In re

B.D. INTERNATIONAL DISCOUNT CORP.,

debtor.

ON consideration of the petition filed on *MAY 13, 1981* against the above named debtor, an order for relief under Chapter 7 of title 11 of the United States Code is GRANTED.

DATED: NOV. 25, 1981

BY THE COURT

BURTON R. LIFLAND
Bankruptcy Judge

**DECISION OF UNITED STATES BANKRUPTCY COURT, SOUTHERN DISTRICT OF NEW YORK ON MOTION TO DISMISS (FILED AUGUST 12, 1981)**

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

No. 81 B 11019

In re

B.D. INTERNATIONAL DISCOUNT CORP.,

Debtor.

DECISION ON MOTION TO DISMISS
INVOLUNTARY CHAPTER 7 PROCEEDING

APPEARANCES:

Orenstein, Snitow, Sutak &
Pollack, P.C.
Attorneys for B.D. International
Discount Corp.
750 Third Avenue
New York, New York 10017

Milbank, Tweed, Hadley &
McCloy,
Attorneys for Respondent
Petitioning Creditor
1 Chase Manhattan Plaza
New York, New York 10005

Burton R. Lifland, *U.S. Bankruptcy Judge*

*Decision*

In this case the moving papers and the initial response framed the issue before the court: whether to dismiss an involuntary Chapter 7 petition against a dealer in money market instruments filed by its primary banker and alleged sole creditor. Accordingly, this decision will begin by addressing the initial arguments.

The proposed debtor, B.D. International Discount Corporation ("BDI"), is a New York corporation that dealt in banker's acceptance and other money market instruments. Chase Manhattan Bank ("Chase"), the petitioning creditor, was BDI's primary banker for over ten years. During that period Chase regularly supplied BDI with statements of its bank accounts.

It appears that in October or November of 1979 Chase erroneously credited BDI's account with sums totaling $7,268,745.92. Subsequently, in November of 1980, pursuant to five money market transfer instructions, a total of $4.3 million was transferred from BDI's account at Chase to Amro Bank, Amsterdam for the account of Segrex, S.A., a Swiss corporation whose relationship to BDI was finally revealed during the last day of the hearings on the motion: it is the sole shareholder of BDI. In the interim period BDI has ceased operating and its tangible assets of $240,000.00 in cash are in an attorney's escrow account. A new entity, B.D. Discount of America, was created on November 28, 1980 and engages in the same type of business as BDI.

Chase asserts that certainly by the spring of 1980 some of BDI's employees and managers were aware of the mistaken transfer and that, thereafter, they engaged in transactions that stripped BDI of its assets. Chase further alleges that BDI admitted its liability for the debt in compromise negotiations had been the parties prior to any litigation involving Chase.

*Decision*

BDI, on the other hand, claims Chase notified it of certain unreconciled balances in November of 1980, and that it (BDI) does not acknowledge its liability to Chase.

On May 1, 1981 Chase commenced an action for conversion in New York State Supreme Court against (1) two employees and officers of BDI, (2) Segrex, (3) B.D. Discount of America (alleging that it was organized to take over the business of BDI) and (4) John Doe one through ten (individuals of unknown identity who Chase alleges have participated as principals and aiders and abettors in the wrongful acts of the other defendants). The proposed debtor, however, was not named as a defendant.

On May 13, 1981, Chase filed an involuntary Chapter 7 against BDI pursuant to §303 of the Bankruptcy Code.[1] BDI then moved to dismiss the petition or alternatively to have the court abstain under §305.[2]

---

1. Title I of the Bankruptcy Reform Act of 1978, Pub.L. 95-598, 92 Stat. 2683, enacted and codified as Title 11 of the United States Code, the "Bankruptcy Code", and all section references cited herein may be found in Title 11, unless otherwise indicated.

2. §305. Abstention.

> (a) The court, after notice and a hearing, may dismiss a case under this title, or may suspend all proceedings in a case under this title, at any time if
>
> (1) the interests of creditors and the debtor would be better served by such dismissal or suspension;
>
> • • •
>
> (c) An order under subsection (a) of this section ... is not reviewable by appeal or otherwise.

*Decision*

Section 303 provides that in order to commence an involuntary case a petition may be filed by the holder of a claim against a person that is not contingent as to liability. BDI contends at the outset that by reason of the pending state court action, no liability had been fixed as of the filing of the petition and that Chase's claim is entirely contingent, thereby excluding Chase as a qualified petitioning creditor.

However, merely setting up a dispute to a claim does not disable one as a creditor under §303. Moreover, the fact that Chase's state court complaint sounded in tort is not dispositive of the issue of contingent liability. As is pointed out by Chase, while its claim against BDI may have some attributes grounded in tort, the debt if need be characterized at all, is basically for money had and received or resulting from a bailment. As stated by Judge Babitt in *In re Friedenberg (Citibank v. Friedenberg)*, Bankr. No. 80 B 10829 (Adversary No. 80-5292A), slip. op. at 7 (Bankr. Ct. S.D.N.Y. July 29, 1981). "This court will not exalt form over substance to the end that it binds itself by the choice of language in another form. (citation omitted) ... [T]his court can look behind the gravamen pleaded to determine the nature of this disputed debt..."

Section 101(11) defines "debt" as "liability on a claim", and Section 101(4)(A) defines "claim" as a "right to payment whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, *disputed*, legal, secured or unsecured." Only the holder of a contingent claim is barred from filing an involuntary petition. [§303(b)(1)]. A claim which is contingent as to liability has been defined as, "one which the debtor will be called upon to pay only upon the occurrence or happening of an extrinsic event which will trigger the liability of the debtor to the alleged creditor and if such triggering event or occurrence was one reasonably contemplated by the debtor and

creditor at the time the event giving rise to the claim occurred." *In re All Media Properties,* 6 B.C.D. 586, 587 (Bankr.Ct. S.D.Tex.1980).

Since there is no extrinsic event contemplated by the debtor and creditor at the time the erroneous transfer occurred that will trigger liability; it is clear that BDI's liability to Chase, while disputed, is not contingent. *See In re Covey,* 7 B.C.D. 1069 (7th Cir. 1981).

The next question posed by the debtor is whether the court can and should issue an order for relief where there may be only one creditor. Section 303(b) provides that where there are fewer than 12 creditors, any one creditor (non-contingent) with an unsecured claim of at least $5,000.00 is necessary to file an involuntary petition. But the debtor questions the standing of a single and *only* creditor to file an involuntary petition.

At least one Bankruptcy Court has held that while the isolated failure to meet a liability to a single creditor will not serve as the basis for an involuntary petition, "no case should be dismissed out of hand upon the bare proposition that there is only one creditor and, hence, for that reason alone no case could ever be made." *In re 7H Land and Cattle Co.,* 2 C.B.C. 2d 121, 6 B.C.D. 128, 6 B.R. 632 (Bankr. Ct. E.D.N.Y. 1980). The standard articulated in *7H* and in *In re Arker,* 3 C.B.C. 2d 121, 6 B.C.D. 128, 6 B.R. 632 (Bankr. Ct. E.D.N.Y. 1980) is that an order for relief can be granted in a single creditor case if (1) the sole creditor would be without an adequate remedy in non-bankruptcy law or (2) there is a showing of special circumstances amounting to fraud, trick, artifice or scam.

*Decision*

In the instant case Chase maintains that fraud on the part of insiders of BDI establishes such "special circumstances". Chase claims that BDI's principal officers knew in the spring of 1980 that BDI held $7.2 million of Chase's money, that they embarked on a scheme to strip BDI of its assets, and that they transferred funds out of BDI to third parties, including $4.3 million to Segrex, its sole stockholder. Chase further asserts that this "looting" of the corporation left a non-working shell and that another company emerged in its place (B.D. Discount of America) to "carry on B.D. International's business without the bother of its obligations to creditors."[3]

It is urged upon the court by BDI that under a single substantial creditor concept this debtor is paying its debts as they become due, which is the antithesis to the standard set forth in §303(h) for the granting of an order for relief. Even if we were to give credence to BDI's assertion that debt, if it exists at all, is due to only one creditor, the special circumstances displayed in the record in this proceeding renders this case ripe for the appointment of a trustee to investigate the affairs of BDI. Therefore this case would be deserving of bankruptcy court administration even if Chase were the *only* creditor. However, as detailed below, it has been determined that on the petition filing date there were at least ten creditors with aggregate debts due of upwards of $120,000 exclusive of the Chase debt.

At the last adjourned hearing the following facts came to light which make it even more appropriate for this court to assume jurisdiction.

---

3. Supplemental memorandum of the Chase Manhattan Bank at 1.

*Decision*

(1) BDI filed its list of creditors pursuant to an order of the court (see also Bankruptcy Rule 104(e)) and revealed that it has three unidentified creditors and five identified creditors, four of whom were contingent and one of whom, Citibank, appeared and represented to the court that it was owed at least $2,300.00.

(2) BDI conceded in open court that Wilkie, Farr & Gallagher, a law firm, was a creditor in the amount of $75,000.00 at the time BDI filed its motion to dismiss the petition, but that they are no longer a creditor, having been paid outside the Bankruptcy Court pending the final hearing on the dismissal motion.

(3) The City of New York has filed a claim for unpaid taxes of $43,320 for the period, 6/1/77 - 5/13/81.

(4) BDI revealed, upon questioning by the court, that Segrex was its sole stockholder.

(5) BDI admitted it received a sum of $710,000.00 in April of 1981 which was not held in escrow, but was transferred to the account of Segrex as a loan.

Therefore, it is apparent that the requirements of §303(b) have been met. Chase is *not* a sole creditor. There are fewer than 12 creditors and one of them holding an unsecured non-contingent claim of at least $5,000.00 has filed the involuntary petition.

Apparently recognizing the dubious application of §303, BDI pitched its alternative dismissal grounds to §305 asking the court to abstain in the best interests of the creditors and the debtor.

The legislative history of §305 indicates that it was intended to give the bankruptcy court flexibility where the debtor and creditors are attempting an out-of-court creditor arrangement.

*Decision*

> The court may dismiss or suspend under the first paragraph, for example, if an arrangement is being worked out by creditors and the debtor out of court, there is no prejudice to the rights of creditors in that arrangement, and an involuntary case has been commenced by a few recalcitrant creditors to provide a basis for future threats to extract full payment. The less expensive out-of-court workout may better serve the interests of the case. . . .

House Report No. 95-595, 95th Cong., 1st Sess. (1977) 325; Senate Report No. 95-989, 95th Cong., 2d Sess. (1978) 35.

In the few cases arising under §305 courts have acknowledged that abstention is appropriate where federal proceedings are not necessary to reach a just and equitable solution. *See, In re Nina Merchandise Corp.*, 2 C.B.C. 2d 1098, 1104, 6 B.C.D. 910, 913, 5 B.R. 743, 748 (Bankr. Ct. S.D.N.Y. 1980, Lifland, B.J.) It is clear that such a situation is not present here.

The facts adduced at the hearings demonstrate that the best interests of the petitioning creditor and the other creditors would *not* be served by abstention. The payment to Wilkie, Farr & Gallagher that occurred during the pendency of these proceedings presents the issue of a voidable post-petition transfer (§549). The "loan" of $710,000 to Segrex is also questionable. In addition, both the disappearance of the $7.2 million (part of which may have indirectly reappeared in Segrex's account) and the demise of BDI followed by the accession of B.D. of America raises the spectre of fraudulent activities mandating Bankruptcy investigation and administration. Furthermore, the very circumstance under which Chase, a 7 million dollar creditor, finds itself without other

creditor companionship [in an asset drained estate] in and of itself suggests the need for Bankruptcy judicial oversight.

Under the jurisdiction of this court a trustee can be appointed to conduct a thorough investigation into BDI's financial affairs, §704(e), and to collect and reduce to money the property of the estate, §703(1). The trustee, with his comprehensive discovery powers, (Bankruptcy Rule 205) and his broad avoiding powers (§§547, 548, 549) will provide a remedy for the creditors that is not available in a non-bankruptcy proceeding.

The facts of this case buttress the need for such a trustee so that dismissal or suspension would be an abdication of the Court's responsibility. *See Nina,* 2 C.B.C. 2d at 1105, 6 B.C.D. at 913, 5 B.R. at 748.

Therefore, based on the foregoing analysis, the motion to dismiss or abstain is denied.

The threshold §303 issue of petitioning creditor eligibility and the abstention request pursuant to §305 having been determined, BDI (if so inclined) may file an answer to the involuntary petition within five days. Such answer shall not raise any of the issues decided herein and shall be limited to the statutory grounds set forth in §303(h)(1)(2).

So ordered.

Dated: New York, New York
August 17, 1981

s/ Burton R. Lifland
BANKRUPTCY JUDGE